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DOCKET No. 10050.

SOUTH TEXAS LUMBER COMPANY,

Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appearances:

For Taxpayer: J. Arthur Platt.

For Comm'r: P. Louis Bergeron.

DOCKET ENTRIES.

1946.

Jan. 25—Petition received and filed. Taxpayer notified.

Fee paid.

Jan. 25—Copy of petition served on General Counsel.

Jan. 25—Request for hearing at Houston, Texas, filed by taxpayer. 1/30/48 Granted.

Mar. 18—Answer filed by General Counsel.

Mar. 21—Hearing set May 13, 1946, Houston, Texas.

Mar. 22—Copy of answer served on taxpayer, Houston, Texas.

May 15—Hearing had before Judge Harland on merits. Stipulation of Facts filed at hearing. Petitioner's brief due 6/29/46. Respondent's Brief due 7/28/46. Reply brief due 8/12/46.

June 12—Transcript of hearing 5/13/46 filed.

June 13—Transcript of hearing 5/15/46 filed.

June 26—Brief filed by taxpayer. 6/27/46 Copy served.

July 29—Brief filed by General Counsel. Copy served 7/30/46.

Aug. 12—Reply brief filed by taxpayer 8/13/46. Copy served.

1946.

- Aug. 30—Findings of Fact and Opinion rendered, Judge Harlan. Judgment will be entered for the respondent. Copy served.
- Sept. 9—Decision entered, Judge Harlan, Div. 11.
- Oct. 7—Motion to vacate decision entered Sept. 9, 1946, filed by General Counsel.
- Oct. 11—Order amending decision entered, Judge Harlan, Div. 11.
- Dec. 2—Petition for review by U. S. Circuit Court of Appeals for the Fifth Circuit with assignments of error filed by taxpayer.
- Dec. 5—Proof of service of petition for review filed.
- Dec. 24—Agreed praecipe for record with proof of service thereon filed.

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## PETITION.

The Tax Court of the United States.

Received Jan. 25, 1946.

Filed Jan. 25, 1946.

South Texas Lumber Company, Petitioner,  
 vs. Docket No. 10050:  
 Commissioner of Internal Revenue, Respondent.

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, symbols "Dallas-IRA-90 D-H", dated November 5th, 1945,

signed by B. W. Wilde, Internal Revenue Agent in Charge, and as a basis for this proceeding alleges as follows:

I.

The petitioner is a corporation incorporated under the laws of the State of Texas, with principal office at Twentieth Floor Sterling Building (P. O. Box 1679), Houston, Texas. The Excess-Profits Tax return for the period here involved was timely filed with the Collector of Internal Revenue for the First District of Texas and on the accrual basis.

II.

The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A", was mailed to the petitioner herein on November 5th, 1945.

III.

The taxes in controversy are Excess Profits Taxes for the calendar year 1943. The Commissioner asserted a deficiency of \$6,797.84. Petitioner admits a deficiency of \$5,089.31, leaving a net amount of \$1,708.53 in controversy.

IV.

The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(A) The Commissioner erred in failing and refusing to include in his computation of the invested capital account of petitioner for the calendar years 1941 and 1942, for the basis of the unused excess profits credit carried forward to the year 1943, so-called by Commissioner "unrealized

profits", on real estate sold on an installment payment plan as follows:

Unreported Profits on Installment Sales.

At January 1, 1941 ..... \$10,984.03

At January 1, 1942 ..... 8,107.20

Commissioner computed the unused excess profits credit carry-over from 1941 and 1942 to the calendar year 1943 at \$44,012.30, while petitioner, by reason of the inclusion of the above unreported profits on real estate installment sales in its invested capital, claims that said carry-over should be \$45,539.59.

(B) The Commissioner erred in refusing to include in the invested capital of the petitioner for the year 1943 for excess profit tax computation \$4,638.49, so-called by Commissioner "unrealized profits" on real estate sold on the installment plan.

V.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(A) Petitioner makes its income and excess profits tax returns on the accrual basis, and so made the same for the calendar years 1941, 1942 and 1943.

(B) Petitioner made sales of real estate in years prior to 1943 with payment on an installment plan, and reported for income tax purposes the profits made therefrom on the installment sales basis.

(C) In each instance the deferred payments on such installment sales were evidenced by the written obliga-

tions of the purchasers, being unconditional promises of the purchasers to pay the amounts shown therein.

(D) Petitioner, being on the accrual basis of accounting, carried on its books as receivables all of the said installment obligations it received from such sales.

(E) On December 31st of the years 1940, 1941 and 1942, there remained unreported for income tax purposes by petitioner of the total net profits realized by it from the sale of real estate on an installment basis prior to January 1st, 1943, the following amounts:

Year of Sale	Net Profit From Sale	Unreported Portion of Net Profit for Taxation		
		12-31-40	12-31-41	12-31-42
1937	24,797.58	8,541.39		
1938	5,867.26	2,442.64		
—				
1937	21,157.24		5,497.90	
1938	5,867.26		1,538.94	
1941	1,092.20		1,070.36	
—				
1937	12,012.82			3,361.56
1938	4,644.96			403.13
1941	1,092.20			873.80
		10,984.03	8,107.20	4,638.49

(F) Petitioner included in the computation of its invested capital for the year 1941 the above amount of \$10,984.03, and in the year 1942 the above amount of \$8,107.20 to arrive at the unused excess profits credit of \$45,539.59 carried over from the years 1941 and 1942 to the year 1943. Commissioner failed or refused to include said amounts of \$10,984.03 and \$8,107.20 in his computation of

invested capital for the years 1941 and 1942 respectively, and thereby arrived at an amount of \$44,012.30 as being unused excess profits carry-over to the calendar year 1943.

(G) Petitioner included the above amount of \$4,638.49 in its invested capital account for excess profits tax purposes for the calendar year 1943. Commissioner refused to allow the inclusion of said amount in invested capital.

(H) Petitioner claims invested capital for the year 1943 is \$1,658,252.96. Commissioner computes invested capital for the calendar year 1943 as \$1,653,614.47.

(I) Petitioner claims that the total net profits from the said real estate sales shown above were realized profits in the years of sale and are includible in the invested capital of petitioner for the year beginning January 1st, next after date of sale, and further claims that by reason of being permitted by law to return said profits for income tax purposes on the installment basis does not preclude petitioner from including all of said profits in its invested capital as here claimed.

## VI.

Wherefore, petitioner prays that the Court hear this proceeding and determine as follows:

(A) That the portion of the net profits on real estate installment sales, although unreported by petitioner for taxation in its income tax returns, should be included in the computation of the invested capital account of petitioner as follows:

For the calendar year 1941.....	\$10,984.03
For the calendar year 1942.....	8,107.20
For the calendar year 1943.....	4,638.49

(B) That the unused excess profits credit carry-over from the years 1941 and 1942 to the calendar year 1943 should be computed on the basis of the inclusion of the amount of \$10,984.03 in the invested capital account of petitioner for the calendar year 1941, and \$8,107.20 in the invested capital account of petitioner for the calendar year 1942.

(C) That the additional excess profit taxes for the calendar year 1943 is \$5,089.31.

SOUTH TEXAS LUMBER COMPANY,

Petitioner,

By T. H. MONROE, Vice-President.

20th Floor Sterling Building,  
P. O. Box 1679,  
Houston 1, Texas.

J. ARTHUR PLATT,  
(J. Arthur Platt),  
Counsel for Petitioner.

20th Floor Sterling Building,  
Houston 1, Texas.

The State of Texas,  
County of Harris.

T. H. Monroe, having been first duly sworn, says on oath that he is Vice President of South Texas Lumber Company, the petitioner above named; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements therein contained; that he signed it in the capacity shown, and that the statements therein contained are true and correct.

T. H. MONROE,  
(T. H. Monroe).

Subscribed and sworn to before me on this the 18th day  
of January, 1946.

(Seal)

BILLIE LENDERMON,  
(Billie Lendermon),  
Notary Public Harris County,  
Texas.

My Commission Expires June 1, 1947.

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EXHIBIT A.

Deficiency Letter.

Treasury Department.  
Internal Revenue Service.  
Dallas 1, Texas.

Office of  
Internal Revenue Agent in Charge,  
Dallas Division.

In Replying Refer to  
Dallas.  
IRA:90D-H.

November 5, 1945.

South Texas Lumber Company,  
20th Floor Sterling Building,  
Post Office Box 1679,  
Houston, Texas.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1942, discloses a deficiency of \$1,563.97 and an overassessment of \$1,902.04 for the taxable year ended December 31, 1943; that

the determination of your declared value excess profits tax liability for the year ended December 31, 1943, discloses a deficiency of \$252.68; that the determination of your excess profits tax liability for the taxable year ended December 31, 1943, discloses a deficiency of \$6,797.84, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 1200 Tower Petroleum Building, Dallas 1, Texas, for the attention of C:RLP. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner,

By (Sgd.) B. W. WILDE,

Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of waiver.

Form 843.

## STATEMENT.

Dallas.  
IRA:90D-H.

South Texas Lumber Company,  
20th Floor Sterling Building,  
Post Office Box 1679,  
Houston, Texas.

Tax Liability for the Taxable Years Ended  
December 31, 1942, and 1943.

## Income Tax.

Year	Liability	Assessed	Over- assessment	Deficiency
1942	\$ 52,135.11	\$ 50,571.14		\$1,563.97
1943	75,366.19	77,268.23	\$1,902.04	
Totals	\$127,501.30	\$127,839.37	\$1,902.04	\$1,563.97

## Declared Value Excess Profits Tax

1943.	\$ 4,034.42	\$ 3,781.74	.....	\$ 252.68
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## Excess Profits Tax.

1943	\$ 14,855.22	\$ 8,057.38	.....	\$6,797.84
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In making this determination of your income, declared value excess-profits, and excess profits tax liability careful consideration has been given to the report of examination dated April 14, 1945.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322 of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the collector of internal revenue for your district, (a) claim for refund on form 843, (a) copy of which is enclosed, the basis of which may be as set forth herein.

Taxable Year Ended December 31, 1942.

### Adjustments to Net Income.

Net income for declared value excess profits  
tax computation as disclosed by return... \$131,756.53

#### Unallowable deductions and additional income:

(a) Depreciation .....	\$3,019.00	
(b) Real estate expense .....	900.00	
(c) Bad debt recoveries .....	283.40	
(d) Capital-stock tax .....	375.00	\$ 4,577.40

Total .....		\$136,333.93
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#### Nontaxable income and additional deductions:

(e) Capital gains .....	\$ 1,068.02	
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Net income for declared value excess profits tax computation adjusted .....		\$135,265.91
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### Explanation of Adjustments.

(a) Depreciation has been adjusted as shown by Exhibit "A" herewith.

(b) To eliminate deduction for commission paid on the Leland B. Jones sale \$250.00, and on the McGregor Street property, \$650.00. Such payments have been allowed as cost of sales.

(c) Of the total recoveries of \$5452.86 in the taxable year the amount of \$283.40 represented 1935 chargeoffs. Since you had a net profit in 1935 the recoveries are deemed to constitute taxable income when collected.

(d) Capital stock tax accrued in taxable year	\$1,875.00
Capital stock tax deducted in your return	2,250.00

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Capital stock tax deduction decreased ....	\$ 375.00
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(e) Capital gains have been reduced in amount of \$1068.02 representing depreciation adjustments on the McGregor Street property which was sold in December, 1942, and adjustments to cost of sales for commissions paid on McGregor Street and Leland B. Jones properties. See adjusting item "(b)" above and Exhibit "B" herewith.

#### Computation of Income Tax.

Net income for declared value excess profits	
tax computation, as corrected .....	\$135,265.91
Less: Dividends received credit .....	3,899.51

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Normal and surtax net income .....	\$131,366.40
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#### Normal Tax:

Tax at 24% on \$131,366.40 .....	\$ 31,527.94
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#### Surtax:

Tax at 16% on \$131,366.40 .....	\$ 21,018.62
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Total normal and surtax .....	\$ 52,546.56
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## Computation of Alternative Tax:

Normal and surtax net income .....	\$131,366.40
Less: Net capital gain .....	2,743.04
	<hr/>
Balance subject to normal and surtax .....	\$128,623.36
Normal Tax:	
Tax at 24% on \$128,623.36 .....	\$ 30,869.61
Surtax:	
Tax at 16% on \$128,623.36 .....	\$ 20,579.74
	<hr/>
Partial tax .....	\$ 51,449.35
Tax at 25% on capital gain of \$2,743.04 .....	685.76
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Alternative tax .....	\$ 52,135.11
Total normal and surtax .....	\$ 52,546.56
Correct income tax liability .....	\$ 52,135.11
Income tax assessed, Account #21157 .....	50,571.14
	<hr/>
Deficiency of income tax .....	\$ 1,563.97

Taxable Year Ended December 31, 1943.

## Adjustments to Net Income.

Net income for declared value excess profits.	
tax computation as disclosed by return...	\$211,296.72
Unallowable deductions and additional income:	
(a) Depreciation .....	\$2,379.38
(b) Capital gain .....	2,074.15
	<hr/>
Total .....	\$215,750.25

## Nontaxable income and additional deductions:

(c) Capital stock tax .....	\$ 625.00
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Net income for declared value excess profits tax computation adjusted .....	\$215,125.25
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## Explanation of Adjustments.

(a) See Exhibit "A" herewith.

(b) See Exhibit "B" herewith.

(c) Capital stock accrued in taxable year....	\$ 2,500.00
Capital stock tax deduction, per return...	1,875.00
	<hr/>
Capital stock tax deduction increased ....	\$ 625.00

## Alternative Tax Computation.

Normal and surtax net income .....	\$190,587.43
Less: Capital gain (Exhibit "B" herewith)....	5,791.88
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Balance subject to normal and surtax .....	\$184,795.55

## Normal Tax:

Tax at 24% on \$184,795.55 .....	\$ 44,350.93
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## Surtax:

Tax at 16% on \$184,795.55 .....	\$ 29,567.29
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Partial tax .....	\$ 73,918.22
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Tax at 25% on capital gain of \$5,791.88 .....	1,447.97
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Alternative tax .....	\$ 75,366.19
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## Computation of Tax.

*Declared Value Excess Profits Tax:*

Net income for declared value excess profits  
tax computation as corrected ..... \$215,125.25

## Less:

10% of \$1,500,000.00 declared value  
capital stock for year ended  
June 30, 1943 ..... \$150,000.00  
85% of \$4706.06 dividends re-  
ceived ..... 3,997.60 \$153,997.60

Balance subject to declared value excess profits  
tax ..... \$ 61,127.65

Tax at 6.6% of \$61,127.65 ..... \$ 4,034.42

Correct declared value excess profits<sup>a</sup> tax lia-  
bility ..... 4,034.42

Declared value excess profits tax assessed,  
Acct. #411100 ..... 3,781.74

Deficiency of declared value excess profits tax \$ 252.68

*Income Tax:*

Net income for declared value excess profits  
tax computation ..... \$215,125.25

Less: Declared value excess profits tax ..... 4,034.42

Net income ..... \$211,090.83

## Less:

Income subject to excess profits  
tax ..... \$16505.80

Dividends received credit ..... 3,997.60 20,503.40

Normal and surtax net income ..... \$190,587.43

**Normal Tax:**

Tax at 24% on \$190,587.43 .....	\$ 45,740.98
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**Surtax:**

Tax at 16% on \$190,587.43 .....	\$ 30,493.99
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Total normal and surtax .....	\$ 76,234.97
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Alternative tax .....	\$ 75,366.19
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Correct income tax liability .....	75,366.19
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Income tax assessed, Account #411100 .....	77,268.23
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Overassessment of income tax .....	\$ 1,902.04
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**Excess Profits Tax.****Adjustments to Excess Profits Net Income for the Taxable Year Computed Under Invested Capital Credit Method.**

Excess profits net income as disclosed by re-	
turn .....	\$196,894.86

As corrected .....	197,807.26
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Net adjustment as computed below .....	\$ 912.40
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**Additions:**

(a) Net income adjustments.....	\$3,828.53
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(b) Capital gains in-	
creased .....	\$2,074.15

(c) Bad debt recover-	
ies .....	589.30

(d) Declared value ex-			
cess profits tax..	252.68	2,916.13	\$ 912.40

## Explanation of Items.

(a) Individual adjustments explained hereinabove following adjustments to net income schedule, year 1943.

(b) To adjust excess profits net income for increase in gain on sale of capital assets. See adjusting item "(b)" Adjustments to Net Income schedule, above.

(c) See Exhibit "C" herewith.

(d) To adjust for deficiency of declared value excess profits tax as shown by Computation of Tax schedule, year 1943, hereinabove.

## Excess Profits Credit—Based on Invested Capital.

	Invested Capital Per Return	Adjustment	As Corrected
Equity invested capital at beginning of taxable year . . . . .	\$1,713,232.48	(a) (4,006.48)	1,709,226.00
Average equity invested capital . . . . .	1,713,232.48	(4,006.48)	1,709,226.00
Reduction on account of inadmissible assets . . . . .	55,611.53		55,611.53
Invested capital . . . . .	\$1,657,620.95	\$(4,006.48)	\$1,653,614.47

## Excess Profits Credit.

Excess profits credit, 8% of \$1,653,614.47 invested capital . . . . . \$132,289.16

## Explanation of Items.

(a) Amount of accumulated earnings and profits, per return .....	\$313,232.48
Amount of accumulated earnings and profits, as corrected .....	309,226.00
Net adjustment, as computed below.....	\$ 4,006.48
Additions:	
(1) Net income adjustments	
1942 .....	\$2,325.98
Deductions:	
(2) Unrealized profits ..	\$4,638.49
(3) Cost depletion .....	130.00
(4) Additional 1942 income tax .....	1,563.97
	<u>6,332.46</u>
Net adjustments as shown above....	\$4,006.48

## Explanation of Adjustments.

(1) Total 1942 adjustments (Adjustments to Net Income schedule, year 1942; hereinabove) .....	\$ 3,509.38
Less:	
Real estate expense transferred to capital gain and unrealized profits .....	..\$900.00
Bad debt recoveries already in surplus .....	283.40 \$ 1,183.40
	<u>1,183.40</u>
Net adjustment affecting surplus .....	\$ 2,325.98
(2) To exclude unrealized profits from installment sales .....	\$4,638.49

(3) To adjust surplus for depletion to the extent of cost for the English Stuart 12 acre lease and the Burt 46 acre lease.

(4) To adjust surplus for amount of income tax deficiency for taxable year 1942.

Taxable Year Ended December 31, 1943.

### Excess Profits Tax Computation.

Excess profits net income, as adjusted.....\$197,807.26

Less:

Specific exemption .....\$ 5,000.00

Excess profits credit ..... 132,289.16

Unused excess profits credit,

(Exhibit "D" herewith) .. 44,012.30 181,301.46

Adjusted excess profits net income.....\$ 16,505.80

90 percent of \$16,505.80 ..... 14,855.22 (1)

Surtax net income (computed without regard to the credit provided by section 26(e)) ..... 207,093.23

80 percent of \$207,093.23 ..... 165,674.58 (2)

Income tax ..... 75,366.19 (3)

Excess of item 2 over item 3..... 90,308.39 (4)

Item 1 or item 4, whichever is lesser..... 14,855.22

Excess profits tax ..... 14,855.22

Excess profits tax due ..... 14,855.22

Post War Refund of Excess Profits Tax and Credit for Debt Retirement.

Excess profits tax, imposed ..... \$14,855.22

Credit allowable under sections 780 and 781..	1,485.52
Net reduction in indebtedness under section 783 .....	None
Credit for debt retirement under section 783..	None
Net post war refund .....	<u>\$ 1,485.52</u>
Correct excess profits tax liability .....	\$14,855.22
Excess profits tax assessed:	
Original account #400402 .....	<u>\$ 8,057.38</u>
Deficiency in excess profits tax .....	<u>\$ 6,797.84</u>

## EXHIBIT C.

## Bad Debt Recovery Adjustments Year ended 12/31/1943.

## 1941:

Total bad debts recoveries .....	\$5,384.99
Less: Recoveries of chargeoffs resulting in No Tax saving .....	<u>1,485.80</u>
Net bad debt recoveries reported as income	\$3,899.19
Less: Recoveries of bad debts charged off subsequent to 1/1/1940 .....	<u>493.64</u>

Bad debt recovery adjustment for Excess Profits Net Income in computation of Excess Profits Credit Carryover .....	\$3,405.55
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## 1942:

Total bad debt recoveries .....	\$5,452.86
Less: Recoveries of chargeoffs resulting in No Tax Saving .....	<u>811.45</u>

Net bad debt recoveries included in income	\$4,641.41
Less: Recoveries of bad debts charged off subsequent to 1/1/40 .....	1,738.85

Bad debt recovery adjustment for excess profits net income in computation of excess profits credit carryover .....	\$2,902.56
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## 1943:

Total bad debt recoveries .....	\$9,707.84
Less: Recoveries of chargeoffs resulting in no tax saving .....	3,640.99

Net bad debt recoveries reported as income.	\$6,066.85
Less: Recoveries of bad debts charged off subsequent to 1/1/40 .....	3,278.22

Corrected bad debt recovery adjustment for excess profits net income .....	\$2,788.63
Per return .....	2,199.33

Net adjustment .....	\$ 589.30
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## EXHIBIT "D".

## Excess Profits Credit Carry-Over Computation.

Year Ended 12/31/1943.

Invested Capital Method.

## 1941:

Money paid in for stock .....	\$ 50,000.00
Stock dividends .....	1,350,000.00
Total capital .....	\$1,400,000.00

Accumulated earning and profits per books—1/1/1941 .....	\$313,152.09		
Less: Cost depletion Burt Lease not on books .....	30.00	313,122.09	
Average invested capital .....		\$1,713,122.09	
Less: Reduction on account of inadmissibles, per return .....		56,982.70	
Invested Capital .....		\$1,656,139.39	
Excess profits credit based on Invested Capital, 8% of above .....		\$132,491.15	
1942:			
Total capital as above .....		\$1,400,000.00	
Accumulated earnings per books— 1/1/42 .....	\$311,936.37		
Less: Cost depletion not on books:			
Burt Lease .....	\$ 30.00		
English Stuart Lease....	100.00	130.00	311,806.37
Average invested capital .....		\$1,711,806.37	
Less: Reduction on account of inadmissibles, per return .....		56,606.63	
Invested Capital .....		\$1,655,199.74	
Excess profits credit based on invested capital, 8% of above .....		\$132,415.98	
1941—Credit .....	\$132,491.15		
Net income as corrected	\$109,075.60		
Less:			
Dividends	\$5,838.84		
Capital gains	3,969.03		
Bad debts	3,405.55	13,213.42	95,862.18
1941 Excess profits credit carry-over .....		\$36,628.97	

1942—Credit .....	\$132,415.98		
Net income adjusted—			
Sched. 1 .....	\$135,265.91		
Less:			
Dividends	\$4,587.66		
Capital			
gains	2,743.04		
Bad debt	2,902.56	10,233.26	125,032.65
1942 excess profits credit carry-over .....		\$ 7,383.33	
Net excess profits credit carry-over to 1943..		<u>\$44,012.30</u>	

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## ANSWER.

Received Mar. 18, 1946.

Filed Mar. 18, 1946.

(Title Omitted.)

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in this appeal, admits and denies as follows:

## I-III.

Admits the allegations contained in paragraphs I, II, and III of the petition.

## IV.

(A)-(B). Denies that the Commissioner erred in the manner alleged in subparagraphs (A) and (B) of paragraph IV of the petition.

## V.

(A)-(B). Admits the allegations of fact contained in subparagraphs (A) and (B) of paragraph V of the petition.

(C)-(D). Denies the allegations of fact contained in subparagraphs (C) and (D) of paragraph V of the petition.

(E). Admits the allegations of fact contained in subparagraph E of paragraph V of the Petition.

(F)-(G). Denies the allegations of fact contained in subparagraphs (F) and (G) of paragraph V of the petition.

(H). Admits that the Commissioner computes invested capital for the calendar year 1943 as \$1,653,614.47, but denies the remaining allegations of fact contained in subparagraph (H) of paragraph V of the petition.

(I). Denies the allegations of fact contained in subparagraph (I) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL, FBS.

(J. P. Wenchel),

Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

JAMES L. BACKSTROM,

Division Counsel,

DONALD ABBEY,

Special Attorney,

Bureau of Internal Revenue.

DA:tew 3-12-46.

23

## STIPULATION OF FACTS.

Filed May 15, 1946.

(Title Omitted.)

It is hereby stipulated and agreed that the following facts are true and correct, without prejudice to the right of either party to offer additional evidence not inconsistent or contrary to the facts herein set out.

1. South Texas Lumber Company, hereinafter referred to as petitioner, is a corporation organized on September 17, 1902, under the laws of the State of Texas, with its principal place of business as a retail dealer in lumber and building material located in Houston, within the First Collection District of Texas.

2. Petitioner keeps its books and files its income and excess profits tax returns on the calendar year and accrual basis.

3. During the course of its business life petitioner acquired title to certain real estate situated in the State of Texas. Beginning with the taxable year 1937, petitioner has made sales of portions of such real estate and, in accordance with section 44(b) of the Internal Revenue Code, has elected to compute and report the profit thereon on the installment basis. In each of the transactions where petitioner made such real estate installment sales, deeds were given to purchasers, and the deferred payments were evidenced by promissory notes executed by the purchaser, payable to the order of petitioner as therein shown, and were secured by vendor's lien and mortgage lien against the land. Petitioner, being on the accrual basis of accounting, carried on its books as receivables all of the said installment obligations so received by it from such sales.

4. The books disclose the following with reference to such sales:

Name—1937	Cost	Sales Price	Profit	Per Cent	Reported Profits 1937-1940	Unreported Profits 12-31-40
Melton .....	0	\$ 1,500.00	\$ 1,500.00	100.00	\$ 877.31	\$ 622.69
Crowley .....	\$ 1,891.69	3,750.00	1,858.31	49.555	600.19	1,258.12
Freitag .....	806.87	2,552.40	1,745.53	68.39	1,186.84	558.69
Lacas .....	610.50	1,931.20	1,320.70	68.39	898.08	422.62
Porter .....	796.63	3,170.00	2,373.37	74.87	1,749.96	623.41
Arls .....	826.97	4,443.00	3,616.03	81.39	2,151.07	1,464.96
Towson .....	2,149.64	8,250.00	6,100.36	73.94	3,882.00	2,218.36
Winn .....	1,019.18	3,224.00	2,204.82	68.39	1,119.05	1,085.77
Rosen .....	3,561.88	4,000.00	438.12	10.95	151.35	286.77
1938						
Speed .....	477.72	1,700.02	1,222.30	71.90	928.95	293.35
Modglin .....	3,034.80	7,679.76	4,644.96	60.48	2,495.67	2,149.29
1941						
Jones .....	3,907.80	5,000.00	1,092.20	21.84	0	0
Totals .....	\$19,083.68	\$47,200.38	\$28,116.70		\$16,040.47	\$10,984.03

5. At the time provided by law petitioner filed corporation income tax (Form 1120) and corporation excess profits tax (Form 1121) returns for the calendar years 1941, 1942 and 1943, disclosing net income and income taxes due thereon for the three years and excess profits tax for the calendar year 1943. In arriving at the net income for the said three years, petitioner reported the following realized profits on the installment sales previously referred to above:

	1941	1942	1943
1937 Sales .....	\$3,043.49	\$2,136.34	\$2,396.87
1938 Sales .....	903.70	1,135.81	403.13
1941 Sales .....	21.84	196.56	190.98
Totals .....	\$3,969.03	\$3,468.71	\$2,990.98

6. The balance sheets attached to and made a part of the income tax returns disclosed the following unreported income from installment sales classified as "Unrealized Profit Installment Sales":

	12-31-40	12-31-41	12-31-42	12-31-43
1937 .....	\$ 8,541.39	\$5,497.90	\$3,361.56	\$ 964.69
1938 .....	2,442.64	1,538.94	403.13	0
1941 .....	0	1,070.36	873.80	682.82
Totals .....	\$10,984.03	\$8,107.20	\$4,638.49	\$1,647.51

7. In its corporation excess profits tax return, Form 1121, for the calendar year 1943, petitioner claimed the unreported income from installment sales, \$4,638.49, as a part of surplus and undivided profits in arriving at its equity invested capital. It also claimed the unreported income from installment sales, \$10,984.03, as at December 31, 1940, and \$8,107.20 as at December 31, 1941, in arriving at its

equity invested capital for the calendar years 1941 and 1942, respectively, for the purpose of its unused excess profits credit carry-over from the calendar years 1941 and 1942 to the calendar year 1943.

8. The capital stock, surplus and undivided profits and reserve for depletion, as disclosed by the balance sheets as at December 31, 1940, December 31, 1941, December 31, 1942, and December 31, 1943, attached and made a part of petitioner's corporation income tax returns, Form 1120, for said years, were as follows:

Year Ended	Capital Stock	Net Surplus	Reserve for Depletion
December 31, 1940	\$1,400,000.00	\$313,152.09	.....
December 31, 1941	1,400,000.00	311,936.37	.....
December 31, 1942	1,400,000.00	307,344.13	\$1,249.86
December 31, 1943	1,400,000.00	320,822.22	2,828.50

Included in the capital stock of \$1,400,000.00 was the original stock issued, \$50,000.00, and \$1,350,000.00 stock dividends subsequently issued.

9. The tax in controversy in this case is the excess profits tax for the calendar year 1943. The Commissioner, as disclosed by the statutory notice of deficiency dated November 5, 1945 (Ex. A of the petition), reduced petitioner's equity invested capital for the calendar years 1941, 1942 and 1943 by the amounts of unreported profits from installment sales previously referred to in paragraphs 6 and 7 above in the respective amounts of \$10,984.03, \$8,107.20 and \$4,638.49.

J. ARTHUR PLATT,

Counsel for Petitioner.

J. P. WENCHEL,

JLB.

(J. P. Wenchel),

Chief Counsel, Bureau of  
Internal Revenue.

## 7 T. C. No. 81.

The Tax Court of the United States.

South Texas Lumber Company, Petitioner,  
vs.

Commissioner of Internal Revenue, Respondent.

Docket No. 10050. Promulgated August 30, 1946.

Petitioner, a corporation which kept its books and filed its income and excess profits tax returns on the accrual basis, elected to compute and report the profit on installment sales of real estate made by it on the installment basis in accordance with section 44(b), I. R. C. *Held*, petitioner's anticipated and unreported income from installment sales as of the beginning of the years 1941, 1942 and 1943 is not includible as part of its "accumulated earnings and profits" in arriving at its equity invested capital within the meaning of section 718 (a) (4), I. R. C.

*J. Arthur Platt, Esq.*, for the petitioner.

*P. Louis Bergeron, Esq.*, for the respondent.

Petitioner seeks a redetermination of a deficiency in excess profits tax for the year 1943 in the original amount of \$6,797.34, which amount, however, has since been reduced by negotiations between the parties leaving a net amount in controversy of \$1,708.53.

The question involved is whether petitioner is entitled to include the anticipated and unreported profits from installment transactions outstanding on its books as at January 1, 1941, 1942 and 1943 as part of its surplus or "accumulated earnings and profits" in arriving at its equity

invested capital within the meaning of section 718 (a) (4),  
I. R. C.

### FINDINGS OF FACT.

This case was submitted on the following agreed statement of facts:

1. South Texas Lumber Company, hereinafter referred to as petitioner, is a corporation organized on September 17, 1902, under the laws of the State of Texas, with its principal place of business as a retail dealer in lumber and building material located in Houston, within the First Collection District of Texas.

2. Petitioner keeps its books and files its income and excess profits tax returns on the calendar year and accrual basis.

3. During the course of its business life petitioner acquired title to certain real estate situated in the State of Texas. Beginning with the taxable year 1937, petitioner has made sales of portions of such real estate and, in accordance with section 44(b) of the Internal Revenue Code, has elected to compute and report the profit thereon on the installment basis. In each of the transactions where petitioner made such real estate installment sales, deeds were given to purchasers, and the deferred payments were evidenced by promissory notes executed by the purchaser, payable to the order of petitioner as therein shown, and were secured by vendor's lien and mortgage lien against the land. Petitioner, being on the accrual basis of accounting, carried on its books as receivables all of the said installment obligations so received by it from such sales.

4. The books disclose the following with reference to such sales:

Name—1937	Cost	Sales Price	Profit	Per Cent	Reported Profits 1937-1940	Unreported Profits 12-31-40
Melton .....	0	\$ 1,500.00	\$ 1,500.00	100.00	\$ 877.31	\$ 622.69
Crowley .....	\$ 1,891.69	3,750.00	1,858.31	49.555	600.19	1,258.12
Freitag .....	806.87	2,552.40	1,745.53	68.39	1,186.84	558.69
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Porter .....	796.63	3,170.00	2,373.37	74.87	1,749.96	623.41
Arks .....	826.97	4,443.00	3,616.03	81.39	2,151.07	1,464.96
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Rosen .....	3,561.88	4,000.00	438.12	10.95	151.35	286.77
1938						
Speed .....	477.72	1,700.02	1,222.30	71.90	928.95	293.35
Modglin .....	3,034.80	7,679.76	4,644.96	60.48	2,495.67	2,149.29
1941						
Jones .....	3,907.80	5,000.00	1,092.20	21.84	0	0
Totals .....	\$19,083.68	\$47,200.38	\$28,116.70		\$16,040.47	\$10,984.03

5. At the time provided by law petitioner filed corporation income tax (Form 1120) and corporation excess profits tax (Form 1121) returns for the calendar years 1941, 1942 and 1943, disclosing net income and income taxes due thereon for the three years and excess profits tax for the calendar year 1943. In arriving at the net income for the said three years, petitioner reported the following realized profits on the installment sales previously referred to above:

	1941	1942	1943
1937 Sales .....	\$3,043.49	\$2,136.34	\$2,396.87
1938 Sales .....	903.70	1,135.81	403.13
1941 Sales .....	21.84	196.56	190.98
Totals .....	\$3,969.03	\$3,468.71	\$2,990.98

6. The balance sheets attached to and made a part of the income tax returns disclosed the following unreported income from installment sales classified as "Unrealized Profit Installment Sales":

	12-31-40	12-31-41	12-31-42	12-31-43
1937 .....	\$ 8,541.39	\$5,497.90	\$3,361.56	\$ 964.69
1938 .....	2,442.64	1,538.94	403.13	0
1941 .....	0	1,070.36	873.80	682.82
Totals .....	\$10,984.03	\$8,107.20	\$4,638.49	\$1,647.51

7. In its corporation excess profits tax return, Form 1121, for the calendar year 1943, petitioner claimed the unreported income from installment sales, \$4,638.49, as a part of surplus and undivided profits in arriving at its equity invested capital. It also claimed the unreported income from installment sales, \$10,984.03, as at December 31, 1940, and \$8,107.20 as at December 31, 1941, in arriving at its

equity invested capital for the calendar years 1941 and 1942, respectively, for the purpose of its unused excess profits credit carry-over from the calendar years 1941 and 1942 to the calendar year 1943.

8. The capital stock, surplus and undivided profits and reserve for depletion, as disclosed by the balance sheets as at December 31, 1940, December 31, 1941, December 31, 1942, and December 31, 1943, attached and made a part of petitioner's corporation income tax returns, Form 1120, for said years, were as follows:

Year Ended	Capital Stock	Net Surplus	Reserve for Depletion
December 31, 1940	\$1,400,000.00	\$313,152.09	.....
December 31, 1941	1,400,000.00	311,936.37	.....
December 31, 1942	1,400,000.00	307,344.13	\$1,249.86
December 31, 1943	1,400,000.00	320,822.22	2,828.50

Included in the capital stock of \$1,400,000.00 was the original stock issued, \$50,000.00, and \$1,350,000.00 stock dividends subsequently issued.

9. The tax in controversy in this case is the excess profits tax for the calendar year 1943. The Commissioner, as disclosed by the statutory notice of deficiency dated November 5, 1945, reduced petitioner's equity invested capital for the calendar years 1941, 1942 and 1943 by the amounts of unreported profits from installment sales previously referred to in paragraphs 6 and 7 above in the respective amounts of \$10,984.03, \$8,107.20 and \$4,638.49.

#### OPINION.

HARLAND, *Judge*: Since the hearing of this case and since the filing of petitioner's brief a case, undistinguishable on its relevant facts from the case at bar, has been decided by this Court. On July 11, 1946, this Court decided in *Kimbrell's Home Furnishings, Inc.*, 7 T. C. No. 40, that a corporation engaged in the sale of furniture at re-

tail on the installment basis could not, in the computation of its equity invested capital, include unrealized profits as represented by unpaid installment notes received from the purchasers at the time of the sale. All of the questions raised by both the petitioner and the respondent herein are fully discussed in the decision in the *Kimbrell's Home Furnishings, Inc.*, case, *supra*.

Petitioner, in his reply brief, seeks to distinguish the *Kimbrell* case from the one at bar due to the fact that in the former case the taxpayer computed its net income on the installment basis as provided by section 44 (a) and its excess profits net income on the accrual basis; whereas in the case at bar the taxpayer filed its income and excess profits tax returns on the accrual basis but "elected to compute and report the profit" from its installment sales under section 44 (a).

The claimed distinction impresses us as being without substance. In both cases the taxpayers included anticipated and unreported profits from installment sales in equity invested capital as "accumulated earnings and profits".<sup>1</sup>

Approval of this treatment of anticipated and unreported profits from installment sales would be equivalent to an admission that a different rule applies in the computation of accumulated earnings and profits for excess profits purposes than in the computation of earnings and profits for income tax purposes. In *Federal Union Insurance Co.*, 5 T. C. 374, we held to the contrary.

*Judgment will be entered for the respondent*

(Seal)

<sup>1</sup> SEC. 718 [I. R. C.] EQUITY INVESTED CAPITAL.

(a) Definition.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts reduced as provided in subsection (b)—

(4) Earnings and Profits at Beginning of Year.—The accumulated earnings and profits as of the beginning of such taxable year; \* \* \*

## DECISION.

The Tax Court of the United States,  
Washington.

South Texas Lumber Company, Petitioner,  
vs. Docket No. 10050.  
Commissioner of Internal Revenue, Respondent.

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated August 30, 1946, it is

Ordered and Decided: That there is a deficiency in excess profits tax of \$1,708.53 for the year 1943.

Enter: Entered Sept. 9, 1946.

(S.) BYRON B. HARLAN,

(Seal)

Judge.

MOTION TO VACATE DECISION ENTERED  
SEPTEMBER 9, 1946.

Received Oct. 7, 1946.

Filed Oct. 7, 1946.

(Title Omitted.)

Now comes the respondent by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and moves that the decision in this case be corrected and as reasons therefor respectfully alleges as follows:

1. By statutory notice dated November 9, 1945, the respondent notified petitioner that it was liable for a deficiency in excess profits tax in the amount of \$6,797.84.

2. Petitioner did not, at any time, file a consent waiving assessment, Form 870, as to any part of said deficiency.

3. On January 25, 1946, petitioner filed a petition with this Court in which it alleged a deficiency of \$6,797.84, in which it admitted a liability of \$5,089.31, leaving a net deficiency of \$1,708.53 in controversy. At no time prior or subsequent thereto did the petitioner attempt to sign or file a Consent to Immediate Assessment (Form 870) as to the \$5,089.31, nor was any of the said \$5,089.31 assessed pending the outcome of this proceeding.

Wherefore, it is prayed that this motion be granted and the deficiency in excess profits tax for the calendar year 1943 as shown in the decision entered September 9, 1946, be vacated and a new decision entered for the full amount of the deficiency of \$6,797.84 in lieu thereof.

(Signed) J. P. WENCHEL, JLB.

(J. P. Wenchel),

Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

JAMES L. BACKSTROM,

Division Counsel,

D. LOUIS BERGERON,

Special Attorney,

Bureau of Internal Revenue.

DLB:jr. 10-2-46.

## ORDER.

The Tax Court of the United States,  
Washington.

South Texas Lumber Company, Petitioner,  
vs. Docket No. 10050.  
Commissioner of Internal Revenue, Respondent.

On motion of respondent it is

Ordered that the decision entered herein September 9, 1946, be and the same is hereby amended to show the amount of the deficiency in excess profits tax to be \$6,797.84, instead of \$1,708.53 as shown in the original decision.

In all other respects the decision shall stand as originally entered.

(Signed) . BYRON B. HARLAN,  
(Seal) Judge.

Dated: Washington, D. C., October 11, 1946.

PETITION FOR REVIEW AND ASSIGNMENTS OF  
ERROR.

36

Received Dec. 2, 1946.

Filed Dec. 2, 1946.

Filed November 1946.

In the United States Circuit Court of Appeals for the  
Fifth Circuit.

South Texas Lumber Company, Petitioner,

vs.

Joseph D. Nunan, Jr., Commissioner of Internal Revenue,  
Respondent.

C. C. A. No. ....

T. C. No. 10050

To the Honorable Judges of the United States Circuit  
Court of Appeals for the Fifth Circuit:

Now comes South Texas Lumber Company, a corporation, by and through its attorney, J. Arthur Platt, and files this, its petition for review by the United States Circuit Court of Appeals for the Fifth Circuit of the decision of The Tax Court of the United States entered September 9, 1946, and amended by an order of the Court dated October 11, 1946, and respectfully shows:

## I.

## Jurisdiction.

The petitioner is a corporation organized and existing under the laws of the State of Texas, with its domicile and principal place of business in the City of Houston,

Harris County, Texas. The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The petitioner, at the time provided by law, filed its federal excess profits tax return for the calendar year 1943, the taxable year here involved, with the Collector of Internal Revenue for the First District of Texas, whose office is located in Austin, Texas, and is within the jurisdictional limits of the United States Circuit Court of Appeals for the Fifth Circuit. The petitioner files this petition pursuant to the provisions of Section 1141 and 1142 of the U. S. Internal Revenue Code.

## II.

### Prior Proceedings.

On November 5, 1945 (Exhibit A of Petition), the respondent determined a deficiency in federal excess profits tax liability against the petitioner in the amount of \$6797.84 for the taxable year 1943, and forwarded to the petitioner by registered mail a notice of said deficiency, in accordance with the provisions of existing Internal Revenue laws. Thereafter, and within the time prescribed by law, petitioner filed an appeal from the said determination with The Tax Court of the United States. The petitioner admitted certain items of assessment, leaving a net amount of \$1708.53 remaining in controversy in this cause. On August 30, 1946, The Tax Court entered its findings of fact and opinion (7 T. C. No. 81). Pursuant to said opinion, The Tax Court entered a decision in this cause on September 9, 1946, wherein and whereby it was ordered and decided that there is a deficiency in petitioner's excess profits tax for the calendar year 1943 in the amount of \$1708.53. Thereafter The Tax Court made and entered its final order in this cause, dated October 11, 1946, whereby

the Court's decision dated September 9, 1946, was amended so as to show the deficiency in petitioner's excess profits tax for the year 1943 in the amount of \$6797.84 instead of \$1708.53, as shown in the original decision.

### III.

#### Nature of Controversy.

Petitioner is seeking a redetermination of a deficiency assessment in excess profits taxes for the calendar year 1943 made against it by respondent in the amount of \$6797.84. Prior to the trial in The Tax Court petitioner admitted certain items of the assessment as being correct, leaving a net amount of \$1708.53 remaining in controversy. The question involved is whether petitioner is entitled to include the profits, unreported for income taxes, derived by it from real estate installment sales, outstanding on its books as at January 1, 1941, 1942 and 1943, as part of its "accumulated earnings and profits" in determining its equity invested capital within the meaning of section 718(a)(4), Internal Revenue Code.

Petitioner is a Texas corporation organized in the year 1902, with its principal place of business as a dealer in lumber and building materials located in Houston within the First Collection District of Texas. Petitioner keeps its books and files its income and excess profits tax returns on the calendar and accrual basis. In the course of its business petitioner acquired title to certain real estate situated in the State of Texas. Beginning with the taxable year 1937, petitioner made sales of portions of such real estate, and as authorized and permitted by Section 44(b) of the Internal Revenue Code, elected to compute, and report the profit thereon on the installment sales basis. In each of the transactions where petitioner made

such real estate installment sales, deeds were given to purchasers, and the deferred payments were evidenced by promissory notes executed by the purchasers, payable to the order of petitioner as therein shown, and were secured by vendor's lien and mortgage lien against the land. Petitioner, being on the accrual basis of accounting, carried on its books as receivables all of the said installment obligations so received by it from such sales.

At the time provided by law petitioner filed corporation income tax (form 1120) and corporation excess profits tax (form 1121) returns for the calendar years 1941, 1942 and 1943, disclosing net income and income taxes due thereon for the three years and excess profits tax for the calendar year 1943. In arriving at the net income for said three years, petitioner reported the following realized profits on the real estate installment sales referred to above:

	1941	1942	1943
1937 Sales .....	\$3,043.49	\$2,136.34	\$2,396.87
1938 Sales .....	903.70	1,135.81	403.13
1941 Sales .....	21.84	196.56	190.98
Totals .....	\$3,969.03	\$3,468.71	\$2,990.98

The balance sheets attached to and made a part of the income tax returns disclosed the unreported income from said real estate installment sales as follows:

	12-31-40	12-31-41	12-31-42	12-31-43
1937 .....	\$ 8,541.39	\$5,497.90	\$3,361.56	\$ 964.69
1938 .....	2,442.64	1,538.94	403.13	0
1941 .....	0	1,070.36	873.80	682.82
Totals .....	\$10,984.03	\$8,107.20	\$4,638.49	\$1,647.51

In its corporation excess profits tax return, Form 1121, for the calendar year 1943, petitioner claimed the unreported income from such real estate installment sales, amounting to \$4638.49, as a part of its surplus and undivided profits in arriving at its equity invested capital. It also claimed the unreported income from said installment sales, \$10,984.03 as at December 31, 1940, and \$8,107.20 as at December 31, 1941, in arriving at its equity invested capital for the calendar years 1941 and 1942, respectively, for the purpose of its unused excess profits credit carry-over from the calendar years 1941 and 1942 to the calendar year 1943. Respondent reduced petitioner's equity invested capital account for the calendar years 1941, 1942 and 1943 by the above mentioned amounts, thereby excluding from petitioner's equity invested capital account for the calendar years 1941, 1942 and 1943 the amounts of profits derived by it from installment sales of real estate made prior to the year 1943 on which petitioner elected to defer payment of income tax in accordance with Section 44(b) of the Internal Revenue Code. The Tax Court sustained the determination of the respondent.

#### IV.

##### Designation of Court of Review.

The petitioner being aggrieved by the opinion and decision of The Tax Court of the United States in its proceeding hereby petitions for a review of said opinion and decision by the United States Circuit of Appeals for the Fifth Circuit, and for the correction of manifest errors which occur therein to its prejudice.

#### V.

##### Assignments of Error.

1. The Tax Court erred in finding and holding that petitioner was not entitled to include the anticipated and

unreported profits, obtained from real estate installment sales made by it and outstanding on its books as at January 1, 1941, 1942 and 1943, as part of its surpluses or "accumulated earnings and profits" in arriving at its equity invested capital within the meaning of Section 718(a), Internal Revenue Code.

2. The Tax Court erred in sustaining the action of respondent in excluding from Petitioner's equity invested capital account for the calendar years 1941, 1942 and 1943 the amounts of profits derived by it from real estate installment sales, made by it prior to the year 1943, on which petitioner elected to defer payment of income taxes in accordance with Section 44(b) of the Internal Revenue Code, it being admitted that petitioner regularly keeps its books and files its income and excess profits tax returns on the calendar year and accrual basis of accounting.

3. The Tax Court erred in finding and deciding that there is a deficiency of \$6797.84 in petitioner's excess profits tax liability for the calendar year 1943.

Wherefore, Petitioner prays that the opinion and decision of The Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Fifth Circuit, that a transcript of the record be prepared in accordance with the law and rules of said Court and be transmitted to the Clerk of said Court for filing; that the opinion and decision of The Tax Court be reversed, vacated and set aside, and the cause remanded, and that petitioner be granted such other and further relief to which it may be entitled herein.

J. ARTHUR PLATT,  
Attorney for Petition.

20th Floor Sterling Building,  
Houston 1, Texas.

The State of Texas,  
County of Harris.

J. Arthur Platt, being duly sworn, deposes and says on his oath as follows:

I am an attorney at law, and am the attorney in the foregoing matter for Petitioner on Review, and as such I am duly authorized to verify the annexed and foregoing Petition for Review; I prepared the annexed and foregoing petition and am familiar with the contents thereof and believe the allegations contained in said petition to be true, and said petition is true according to the best of my knowledge, information and belief. Said petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

J. ARTHUR PLATT,  
(J. Arthur Platt).

Subscribed and sworn to before me by J. Arthur Platt on this the 27th day of November, 1946.

(Seal)

MYRA HEMPHILL,  
(Myra. Hemphill),  
Notary Public, Harris County,  
Texas.

My Commission Expires June 1, 1947.

NOTICE OF FILING PETITION FOR REVIEW AND  
ACCEPTANCE OF SERVICE THEREOF.

43

Filed Dec. 5, 1946.

Filed December . . 1946.

In the United States Circuit Court of Appeals for the  
Fifth Circuit.

South Texas Lumber Company, Petitioner,

vs.

Joseph D. Nunan, Jr., Commissioner of Internal Revenue,  
Respondent.

C. C. A. No. ....

T. C. No. 10050

The Honorable J. P. Wenchel, Chief Counsel,  
Bureau of Internal Revenue,  
Washington, D. C.

You are hereby notified that South Texas Lumber Company has filed with The Tax Court of the United States at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Fifth Circuit of the decision of The Tax Court of the United States heretofore rendered in the above entitled cause. A copy of the Petition for Review and Assignments of Error, as filed, is hereto attached and served on you.

Dated this the 2nd day of December, 1946.

(S.) J. ARTHUR PLATT,

(J. Arthur Platt),

Attorney for Petitioner on  
Review.

Personal service of the annexed and foregoing notice, together with a copy of the Petition for Review and Assignments of Error mentioned therein, is hereby acknowledged on this the 4th day of December, 1946.

(S.) J. P. WENCHEL, SLY.

(J. P. Wenchel),

Chief Counsel, Bureau of Internal Revenue, Washington, D. C., Attorney for Respondent.

45

# PRAECIPE FOR RECORD.

Received Dec. 24, 1946.

Filed Dec. 24, 1946.

(Title Omitted.)

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit copies, duly certified as correct, of the following documents and records in the above styled cause in connection with the Petition for Review by the said Circuit Court of Appeals for the Fifth Circuit heretofore filed by South Texas Lumber Company, in the above named petitioner:

1. Docket entries of the proceedings before The Tax Court;
2. Pleadings:

(a) Petition and attached notice of deficiency dated November 5, 1945, filed January 25, 1946;

(b) Answer of Commissioner filed March 18, 1946.

3. Stipulation of Facts filed at hearing in The Tax Court May 15, 1946;

4. Findings of Fact and Opinion of The Tax Court of the United States promulgated August 30, 1946;

5. Decision entered by The Tax Court September 9, 1946;

6. Motion of respondent to vacate decision of September 9, 1946, and for entry by The Tax Court of a new decision, filed October 7, 1946;

7. Order of The Tax Court filed October 11, 1946, amending previous decision dated September 9, 1946;

8. Petition for Review and Assignments of Error filed by petitioner on December 2, 1946;

9. Notice of filing Petition for Review and Assignments of Error, and acceptance of service by respondent filed December 4, 1946;

10. This Praecipe for Record, with respondent's acceptance of notice thereof;

11. Certificate and Seal.

J. ARTHUR PLATT,  
(J. Arthur Platt),  
Counsel for Petitioner on  
Review.

20th Floor Sterling Building,  
Houston, Texas.

Service of a copy of this Praeipie for Record is hereby  
accepted and agreed to on this the 9th day of December,  
1946.

J. P. WENCHEL, CCR.  
(J. P. Wenchel),  
Chief Counsel, Bureau of  
Internal Revenue.

**CERTIFICATE.**

**The Tax Court of the United States,  
Washington.**

**South Texas Lumber Company, Petitioner,  
vs. Docket No. 10050  
Commissioner of Internal Revenue, Respondent.**

**I, VICTOR S. MERSCH, Clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 46, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.**

**In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 14th day of January, 1947.**

**(Seal)**

**VICTOR S. MERSCH,  
Clerk, The Tax Court of the  
United States.**

**EMT.**

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

*Argument and submission.*

Extract from the Minutes of June 4, 1947

No. 11,896

SOUTH TEXAS LUMBER COMPANY

v.

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and, after argument by J. Arthur Platt, Esq., for petitioner, and Carlton Fox, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

**OPINION OF THE COURT. FILED JULY 3, 1947**

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 11896

SOUTH TEXAS LUMBER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the Tax Court of the United States

(July 3, 1947)

Before SIBLEY, HOLMES, and WALLER, Circuit Judges

WALLER, Circuit Judge: The Taxpayer, a corporation under the laws of Texas, which keeps its books and files its income and excess profits tax returns on the calendar year and on the accrual basis, made sales of certain real estate and elected to compute and report the profit from such sales on the installment basis as provided by Sec. 44b of Internal Revenue Code. The question presented is whether or not in computing the income and excess profits tax of the corporation for the year 1943 the corporation may, for excess profits credit, include as "equity-invested capital" uncollected profits which had been accumulated on its books on January 1, 1941, from such installment sales on the theory that

such profits, although uncollected, represent "accumulated earnings and profits as of the beginning of the taxable year" under Sec. 718 (a) (4) of the Internal Revenue Code, which provides that equity-invested capital shall include "the accumulated earnings and profits as of the beginning of said taxable year; \* \* \*"

In making the sales of the real estate on the installment plan, a deed was executed and delivered to the purchaser, with a vendor's lien retained to secure payment of the promissory notes, for the balance, which notes the purchaser had executed to the corporation. Being on the accrual basis of accounting, the corporation carried on its books as receivables all of these installment obligations, but for income tax purposes it showed as unreported income under the classification of "Unrealized Profit Installment Sales" such part of the proceeds from the installment sales that remained uncollected, and in its excess profits tax return for the year 1943 it claimed the unreported income, or that part not yet collected from the installment sales, as a part of its surplus and undivided profits in computing its equity-invested capital.

In redetermining the Taxpayer's excess profits tax for the calendar year 1943 the Commissioner reduced its equity-invested capital for the calendar years of 1941, 1942, and 1943, by the full amount of the sums so carried as unreported income or profits from those installment sales for the said three years.

The term "accumulated profits" is not defined in the excess profits tax provisions of the statutes, but Sec. 728 provides that "the terms used in this subchapter shall have the same meaning as when used in chapter 1." The Commissioner contends:

(1) That whether uncollected profits on installment sales at the beginning of the taxable year are includible in the equity-invested capital depends on whether such profits are "recognized in computing net income" as provided in Sec. 115 (1) of Chapter 1 as added by Sec. 501 (a) of the Second Revenue Act of 1940, and that since the Taxpayer did not report in its income tax return the uncollected profits under the installment sales in computing its net income, such profits, therefore, were not "recognized in computing net income" and, therefore, are not includible in the term "equity-invested capital" for excess profits tax purposes.

(2) That Congress, in enacting Sec. 115 (1), intended to approve an administrative definition of "earnings and profits" in determining the source of divided distribution under 115 (a) and that such long-standing definition should be applied in computing "earnings and profits" in determining equity-invested capital under Sec. 718 (a) (4).

(3) That Sec. 115 (1) makes "recognition" in computing net income the test, and that income that is returned under the installment sales statute (44 (a) and (b)) is so "recognized", but that the uncollected profits on these installment sales which are merely shown in the income tax return as "Unrealized Profit Installment Sales" are not included in the income tax return and hence they are not "recognized" so as to be includible in earnings and profits.

(4) That Sec. 19.115-3 of Regulations 103 expressly provided that uncollected profits shall not be included in "earnings and profits", and that the Taxpayer's attack on the definition of earnings and profits that makes "recognition" instead of "realization" the test will not result in the regulation being stricken down unless it is clearly erroneous and unreasonable.

The Taxpayer insists that income tax consequences accrue upon the realization of income rather than upon its recognition, and that under the installment plan of income tax reporting, which the statute gives it the right to adopt, there was no actual realization of the income on the unpaid balances in the installment sales such as made it appropriate to return the same, but that said unpaid balances on such installment contracts were "accumulated earnings and profits at the beginning of the taxable year" within the language and purpose of Sec. 718 (a) (4).

If the Taxpayer had returned and paid the profits that accrued on each sale in the year in which such sale was made, the Commissioner would not contend that the accumulated earnings and profits represented in the unpaid installments would not then have been includible in equity-invested capital for excess profits tax purposes. He would, however, deny to the seller of property on the installment plan, who makes his income tax return according to the optional method that Congress has allowed in 44 (b), the right to recognize in his income tax return the unrealized earnings and profits thus accumulated and accrued on its books and to take credit therefor as equity-invested capital in his excess profits tax return.

The Tax Court held with the Commissioner, citing in support of its holdings its own opinion in *Kimbrell's Home Furnishings, Inc.*, 7 T. C. 40, which case was subsequently reversed by the Circuit Court of Appeals for the Fourth Circuit in an opinion reported at 159 F. 2d 608.

Definitely there were accumulated as a legitimate part of the corporation's surplus earnings and profits as of the beginning of the taxable year which would have been taxable (or recognized) as gains had it not been for the option given the Taxpayer under Sec. 44 (b) to defer income tax payments on profits from installment sales until the time of their realization.

It is believed that if Congress had intended to restrict the earnings and profits includible in equity-invested capital to those earnings and profits on which the corporation had in the taxable year paid income taxes, and also had intended to burden the option it had given in 41 (b) by excluding profits from installment sales from being characterized as "accumulated earnings and profits" under Sec. 718 (a) (4), it would have said so in plain words so that the Commissioner would not be called upon to resort to an argument so tenuous that it is necessary to pull in Sec. 115 (1), 501 (9), and 111 (d) to prove that Sec. 718 (a) (4) does not mean what it says.

The question has already been decided by this Court in *Commissioner v. Shenandoah Company*, 138 F. 2d 792, contrary to the contentions of the Commissioner, and we think the holdings announced in that case, which were approved by the Fourth Circuit in the *Kimbrell* case, *supra*, were correct and are controlling in the present case.

In our view the decision of the Tax Court is not in accordance with law, and the same is hereby

REVERSED.

HOLMES, Circuit Judge, dissenting: I would affirm the decision of the Tax Court, since it seems to me that the decision of this court in *Commissioner v. Shenandoah Company*, 138 F. (2d) 792, has in principle been overruled by *Commissioner v. Wheeler*, 324 U. S. 542.

A true copy.  
Teste.

### *Judgment.*

Extract from the Minutes of July 3, 1947

No. 11896

SOUTH TEXAS LUMBER COMPANY

*v.*

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of South Texas Lumber Company for a review of a decision of the Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby reversed. "Holmes, Circuit Judge, dissents."

*Clerk's certificate*

United States of America

United States Circuit Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 51 to 58, next preceding this certificate, contain full, true, and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 11896, wherein South Texas Lumber Company is petitioner, and Commissioner of Internal Revenue is respondent, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record, numbered from 1 to 50, are identical with the printed record upon which said cause was heard and decided in the said United States Circuit Court of Appeals for the Fifth Circuit.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, this 8th day of September A. D. 1947.

[SEAL]

(S) OAKLEY F. DODD,  
*Clerk of the United States Circuit Court  
of Appeals, Fifth Circuit.*

## Supreme Court of the United States

*Order allowing certiorari*

Filed November 24, 1947

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.